No. 319

In the

Supreme Court of the United States

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, TRUSTEE OF FIDELITY ASSURANCE ASSOCIATION,
Petitioners,

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, ETC., ET AL.,
Respondents.

JOINT REPLY TO PETITION FOR WRIT OF CERTIORARI ON BEHALF OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER FOR FIDELITY ASSURANCE ASSOCIATION IN THE STATE OF MISSOURI.

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BAIRD-WARD—NASHVILLE

FOREWORD.

"We think it is our duty to review the situation realistically, and when this is done, there appears to be no reasonable hope of the reorganization of the business as a going concern, but only the immediate need of a liquidation of the company's assets for the benefit of the contract holders."

Opinion of Court of Appeals.

"It is true that the broad picture developed by the testimony at the hearing does not present a very favorable view with respect to the rehabilitation and continued operation of the Debtor as a face-amount certificate company."

Opinion of District Judge.

In the

Supreme Court of the United States

FIDELITY ASSURANCE ASSOCIATION AND CENTRAL TRUST COMPANY, TRUSTEE OF FIDELITY ASSURANCE ASSOCIATION,

Petitioners,

vs.

EDGAR B. SIMS, AUDITOR OF THE STATE OF WEST VIRGINIA, ETC., ET AL.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.
JOINT REPLY OF L. H. BROOKS, TRUSTEE, FREDERIC LEAKE AND A. L. GOLDBERG, JR., TRUSTEE, AND DEWEY S. GODFREY, RECEIVER IN THE STATE OF MISSOURI, RESPONDENTS.

MAY IT PLEASE THE COURT:

The Issue—*Central Trust Company v. Contract Holders.*

In order that we may avoid the awkward and aweless position of straining at a gnat and swallowing a camel, let us recur at the outset to the question, What is the object of this suit? Anyone reading the petition presented in this case might easily lose sight of the fact that the primary and basic issue is whether or not this insolvent company *should* be reorganized.

It is not of the greatest importance whether everyone can assent to the process of reasoning by which the Court of

Appeals reached its conclusion that the corporation was an insurance corporation and hence excluded from the Bankruptcy Act. The effect of the decision was that there should be an immediate liquidation for the benefit of the contract holders instead of a deferred and slow liquidation for the benefit of the Central Trust Company.

The gist of the opinion of the Court of Appeals is expressed in the following sentence:

> "It has not been and cannot be reasonably contended that the interests of the well secured creditors will be advanced by interfering with the state officials in the prompt liquidation and distribution of the securities in their hands. The liquidation in every state in which deposits were made will be subject to the supervision of established governmental departments, as well qualified for the business as the trustee in bankruptcy. There is every reason to believe that the liquidation under their supervision will proceed without needless expense in a careful and expeditious manner so as to save as much as possible for the contract holders. *Certainly it would be unjust and unreasonable to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained.*" (Italics ours)

We submit that no other decision would have met the demands of justice for the eighty thousand contract holders whose rights have been placed in jeopardy by this proceeding. Had the case not been wholly excluded from the Bankruptcy Courts, these contract holders whould have been left defenseless against harassment and delay from further efforts to deprive them of the right to the imme-

diate distribution of the State deposits securing their claims.

Pressing Need for Liquidation in Tennessee.

The statutes of the State of Tennessee require investment companies, such as the Debtor, as a condition to the right to engage in business in that State, to deposit and maintain securities at no time less than 100 per cent of the issuing company's cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee. By Chapter 209 of the Public Acts of 1939, it was provided that the Commissioner of Insurance and Banking of the State of Tennessee should hold as Custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of said Act. By Chapter No. 157 of the Public Acts of 1941, the State Treasurer of Tennessee was made the Custodian of all securities deposited with the State or any Department thereof. The laws of Tennessee further provide that only upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee, and for which trust deposit is maintained, shall the issuing company be entitled to a release and return of the securities so deposited.

In compliance with the laws of the State of Tennessee, and in order to obtain a permit to do business and issue its investment contracts in the State of Tennessee, the Debtor company made a deposit of securities with the Commissioner of Insurance and Banking of the State of Tennessee. Citizens of the State of Tennessee, in reliance upon the protection afforded by the laws of that State, purchased the investment contracts issued by Debtor.

The transcript of the proceedings in the Chancery Court of Davidson County, Tennessee, filed as an exhibit to the answer of the defendants to the Debtor's petition for reorganization shows that prior to the time the petition was filed, a suit was pending in the State Court to subject the deposit in Tennessee to the satisfaction of the claims of contract holders entitled to the benefit of deposit in that State. The deposited securities were then being held by the State Treasurer in pursuance to the statutes of that State, making him the Custodian of the deposit. By decree of the Chancery Court he had been enjoined from disposing of the deposit in any way except under orders of that Court. The time had been fixed for the filing of the claims of creditors and many claims had already been filed. Since that time many other claims have been filed. The time expired on November 1st, 1941.

But for the injunction or stay in the order of August 9, 1941, the Tennessee State Court could have proceeded with the distribution of the deposit in Tennessee after November 1, 1941. *The Debtor has no equity in the Tennessee deposit.* (Tr.; p. 225)

By reason of these facts, the deposit in Tennessee cannot be affected in any way by any attempt to reorganize the Debtor except by delaying distribution. Even if there is an attempt to effect a plan of reorganization, any plan of reorganization must give the Tennessee contract holders the option of obtaining satisfaction of their entire claims out of the deposit in Tennessee. This deposit under the laws of the State cannot be withdrawn until the discharge in full of all claims of Tennessee contract holders. Since in Tennessee the Insurance Commissioner is prevented by statute from giving an investment company a license to do busi-

ness unless it maintains a deposit of 100% of the amount of its cash liabilities to the holders of investment contracts sold in the State, there can be no scaling down *in invitum* of the claims of contract holders against the deposit so as to free any of the deposited securities for use in equalizing deficiencies in other States or to furnish working capital.

Respondents duly moved to vacate and set aside the stay order made by the District Court so as to permit the Chancery proceedings in the State Court to be prosecuted. Their motion was overruled by the District Judge. The Court of Appeals correctly envisaged the situation with respect to the State deposits generally, and concluded that it would be unjust and unreasonable to these contract holders to delay the satisfaction of their claims in order that illusory hopes of reorganization may be entertained.

Pressing Need for Liquidation in Missouri.

It is to the Missouri deposit that the Missouri contract holders must look for payment. The Commissioner of Securities in Missouri required the Debtor corporation, as a condition to the right to do business in that State, to deposit in trust for the benefit of Missouri contract holders securities equal to the amount of outstanding liabilities in that State. Prior to the appointment of the State Court receivers and prior to the filing of the petition for reorganization, the Attorney-General for the State of Missouri on the information of the Commissioner of Securities instituted a proceeding in the Missouri State Court and obtained the appointment of a receiver.

When the Missouri contract holders purchased their contracts, they were led to believe (as shown by Exhibits 37,

38, 39, 40, 85, 86 and 87) that they need look no further than the Missouri deposit for their protection, in payment of their contracts. The question with them is, when are they going to get their money? None of them would have turned his money over to Fidelity if he had contemplated the slightest possibility of the deposit in his State becoming involved in protracted and expensive litigation in a Federal Court nearly one thousand miles distant.

The Missouri contract holders are not concerned with the deposits in the State of Maryland or in Tennessee or in West Virginia, or in any other State which required deposits for the protection of contract holders in that State. They have no purpose to deprive any other State of any of the benefits of deposits made therein in accordance with applicable laws and regulations of the several Insurance and Securities Commissioners. The claim of the average contract holder is of a small amount. They can see nothing but injustice to the contract holders in any scheme or plan that has for its purpose the handling of all claims of all contract holders in the State of West Virginia, regardless of the State in which the contract holders reside.

There have been protestations of good faith by the various counsel who have appeared for the company in this proceeding, as well as the attorneys for the Central Trust Company, and assurances from them that they have no purpose but to do "equity" to *all* contract holders. Despite this, the Missouri contract holders know that the maintenance of this proceeding forebodes no good for them. They know that this proceeding would not be maintained for the purpose of upholding and enforcing their rights in the deposit which secures their claims. That object would be best accomplished in their own State. The proceeding has a

meaning only if the object is to destroy or alter their rights in their deposit, either by cutting down their claims or postponing the time of payment. This does not seem to be "equity" to them.

State Deposits Do Not Constitute "Assets" Which May Be Made Basis of Reorganization.

The very pertinent fact that Fidelity has nothing of its own to reorganize with is obscured by petitioners' statement that its aggregate assets amount to $21,100,000.00 or approximately ninety per cent of its aggregate liabilities, $23,476,000.00. The Court of Appeals showed the situation by a tabulation of the State deposits as compared with liabilities. (Tr., p. 366) At the time of the filing of the petition, as the Court of Appeals points out, Fidelity's undeposited assets amounted to only a little more than a million dollars. And there was a deficiency of nearly three million five hundred thousand dollars between the deposits and the liabilities secured by the several deposits.

In this case *all* of the creditors are contract holders holding *secured claims*. Approximately $10,000,000.00 of securities, at the time of the filing of the petition, were held in deposits in States other than West Virginia. These fourteen other States are shown on Exhibit 48 printed in transcript at page 225. A little more than $10,000,000.00 of securities were deposited in West Virginia. This deposit was not made, however, for the sole benefit of contract holders in the State of West Virginia, but under the laws of that State supplied the deficiency between the deposits in all of the other States in which the company did business and the liabilities secured.

In the heading at the top of the page of each contract, the Company agreed to deposit approved securities in trust as required by the laws of the State of West Virginia. The laws of the State of West Virginia required a deposit *in trust* of bonds and securities approved by the Insurance Commissioner "to an amount equal to the total amount which such person, association or corporation may be liable to pay in cash to the holders of contracts under the terms thereof at the time of the deposit." It was further provided by the West Virginia statute that wherever other States required the corporation to make deposits to secure contract holders, the amount of the deposits in such other States might be deducted from the total amount required to be deposited with the Treasurer of the State of West Virginia.

These provisions, which were a part of the West Virginia laws, were, of course, by the provisions of the contract incorporated as a part of the contractual obligations of the Investment Company. Thus, when the Company deposited securities in Tennessee in accordance with the laws of the State of West Virginia, credit therefor was given against the West Virginia deposit. This was in compliance with the provisions of the contract that a reserve fund would be invested in approved securities and *deposited in trust*.

The Tennessee statutes in this regard are unambiguous. The amount of the deposit was to be not less than one hundred per cent of the cash or current contract liability on all outstanding investment contracts sold in the State of Tennessee. We mention Tennessee because we think its law is fairly typical of the laws of the thirteen other States (other than West Virginia) which required deposits.

While there is some slight difference between the wording of the section relating to the reserve fund contained in the different contracts, in substance the provision is the same. By this section (Section 1, Reserve Fund), the Company agreed to create and maintain a reserve fund. It was to be a special fund for the discharge of its liability under the different Series contracts. The reserve fund was to be set aside from payments received under the different Series contracts. This reserve fund by the terms of the contracts was to be invested in approved securities *and deposited in trust, as required by the laws of the State of West Virginia.* Plainly when the securities were *deposited in trust*, as required by the laws of the State of West Virginia, a valid trust came into existence.

Manifestly, no sort of a plan of reorganization could be effected which does not deal with the deposited securities. These represent by far the greater part of the company's assets. The non-deposited securities and assets would be consumed in paying taxes, expenses of administration, fees, etc. Debtor's petition shows that the prospect of reorganization depends entirely upon some modification of the rights of *all* contract holders in these deposited securities. It presupposes some kind of omnipotence in the Federal Court capable of effecting a recapture of these deposits for use in supplying the deficiency of more than three and a half million dollars between the assets and liabilities of the company so that it can continue in business.

In other words, Debtor's petition necessarily contemplates the carving of working capital out of the assets held in trust for contract holders. The petition is not copied in the printed transcript. For the convenience of the Court,

we have printed the pertinent Sections VII and VIII as Appendix B to this brief.

There could be no sort of reorganization that does not eliminate the deficiency between assets and liabilities. If the company is to continue in business as a face-amount certificate company, as an insurance company, or as any other kind of company, it would have to be launched in a condition of solvency. The only other alternative, it occurs to us, would be the sale or transfer of a part of the Debtor's business to some other company that is already functioning; and again insolvency is a barrier to such a plan. No businessman would take over assets with liabilities in excess of what he is getting.

Now when a business is insolvent—that is, when its liabilities are in excess of its assets—solvency can be attained in one of two ways only. Either the assets must be increased or the liabilities must be decreased. The assets of this company can be brought up to equal its liabilities only by new money being put in from the outside. All will agree that this is out of the question. The efforts of the company's directors and officers extending over a period of several years prior to the filing of the petition to bring in new capital demonstrate that this possibility has already been exhausted. (See Letter from John Marshall, Printed transcript, pp. 303-309.)

This leaves the possibility of scaling down the liabilities. It would not be enough to make them merely equal the assets. The liabilities would have to be reduced to an amount much less than the assets so as to free money from the trusts in which the securities are held to make capital and for use in paying operating expenses. It is our belief

that nothing like this has ever been attempted in the annals of corporate reorganizations.

Any plan which compels secured creditors to surrender without adequate consideration for the benefit of other creditors, whether secured or unsecured, the superior rights which they have acquired is inequitable and unfair.

The contract holders in those States having fairly adequate deposits cannot be required to surrender any of the rights and protection afforded to them by statutes in those States for the benefit of their less fortunate brethren in the other States where a disparity between deposits and liabilities is found. This Court has no power to legislate. It has no power to readjust deposits, for to do so would be to impair liens created by State laws. This is prohibited by Section 67(b) of the Bankruptcy Act, which by virtue of Section 102 is applicable to proceedings under Chapter X.

Great stress is placed by the petition upon the fact that there is some inequality as between the States having deposits and other States which either do not have any deposits or smaller deposits. If we grant the disparity which exists, the Federal Courts nevertheless have no power to change the situation which exists.

The Securities and Exchange Commission had been studying investment trusts and investment companies five years before the Investment Company Act undertaking to regulate face-amount certificate companies was recommended to Congress for enactment. The study was commenced in pursuance to the mandate contained in Section 30 of the Public Utility Holding Company Act of 1935 (15 U.S.C.A., Sec. 79z-4).

The Investment Company Act of 1940 (Title 15 U.S. C.A., Sec. 80a) expressly recites that it was upon the basis of facts disclosed by the record and reports of Securities and Exchange Commission and facts otherwise disclosed and ascertained, that it was found that investment companies were affected with a national public interest. The Securities and Exchange Commission made a special report on companies issuing face-amount installment certificates which was a part of its over-all report on its study of investment trusts and investment companies. Chapter V of this Special Report deals with the subject of Governmental Regulation of face-amount certificate companies.* On Page 128 is set out a summary of the deposit requirements of the various State statutes. The table 34 on page 130 sets out the amount of deposits and cash surrender liability of certificates outstanding of Fidelity Investment Association by States as of December 31, 1937.

In 1938, the Securities and Exchange Commission had obtained an injunction in the United States District Court for the Eastern District of Michigan against Fidelity Investment Association, enjoining it, among other things, from: "A. 1. Purchasing and depositing with West Virginia, or any other State, insufficient securities or securities which do not meet deposit requirements." (Special Report, p. 257).

The variation in State deposit laws was made the subject of a special study by the Senate and House Committees, to

*It is significant that it was reported that these companies "are essentially moneyed corporations, the regulation of which would seem to present problems in many respects comparable to the regulation of other types of money corporations *such as insurance companies and banks.*" (p. 123)

which the Investment Company Act was referred. Commissioner Healy was the first to point it out. (See hearings before Sub-Committee of the Committee on Interstate and Foreign Commerce on H R. 10065, Page 62.)

Mr. Schenker, counsel for the Securities and Exchange Commission made the following statement:

"... this bill in no way, Senator Herring, touches deposits that have been made to secure certificates issued up to the time of the passage of this bill". (Printed transcript p. 234.)

The report of Senator Wagner, Chairman of the Committee on Banking and Currency, accompanying the bill, states:

> *"The bill preserves the rights of residents in those States which require specific deposits with their State officials but makes provision for equalization of treatment of all certificate holders,* by providing that residents of other States must receive an amount equal to that received by the residents of States with deposits, before the latter can share in the general assets of the bankrupt company. (Sec. 29.)" (Italics ours)

We ask the Court to give special attention to the memorandum as to the hearings preceding the enactment of the Bill set out in the printed transcript at pages 226 to 237.

The Act contained an express reservation of the jurisdiction of State authorities. Section 50 provides as follows:

> "... nor shall anything in this title affect the jurisdiction of any other commission, board, agency, or officer of the United States or of any State or political

subdivision of any State, over any person, security, or transaction, insofar as such jurisdiction does not conflict with any provision of this title or of any rule, regulation, or order hereunder."

The proof is irrefragable that Congress thoroughly considered the question of the application of the bankruptcy power to the then existing deposits and deliberately decided to confer *no power* upon the Bankruptcy Court over deposits as they existed when the Act took effect.

Validity of State Deposits Unquestioned.

To this date (one year and nine months after the effective date of the Investment Company Act and Debtor's discontinuance of the issuance of new certificates), there has been no pleading filed in this case nor in any of the fourteen States in which Fidelity had deposits, nor anywhere else, in any way questioning the validity of the State deposits. The Court of Appeals assumed without argument that all of them must be given effect to. During the hearing the District Judge set aside the order made at the time of the presentation of the petition for reorganization which directed all of the deposits to be surrendered to the Trustee. His opinion takes note of the possibility of questions as to the deposits being raised but proceeds upon the assumption that recognition must be given to the State deposits.

We venture the assertion that rarely is a case presented to this Court in which testimony on the hearing on the issue of good faith was permitted to take so wide a range. Every phase of the company's activities was probed by those who endeavored to sustain the petition. We do not believe that there is any other evidence available to the

proponents of reorganization which will afford them any support in an effort to assail the State deposits.

How can it successfully be contended that all of the precautions which the States took for the protection of the investors in this Company against the day when there might be some failure on the part of the company to meet its obligations, *now that that day has arrived, must be held for naught?* Surely no court of equity would countenance for a minute such an attempt to undo the valid and salutary safeguards thrown up by the States to protect their citizens against the disaster which has come, except on grounds of a clear violation of some express prohibition in the Federal Constitution against State legislation of such character. No such suggestion has been made.

Fidelity never came under any Federal regulation. During its entire existence it was regulated by the State authorities. All of the deposits which were made were in pursuance to State laws. No reason whatsoever is shown why the Federal Court should have any jurisdiction to nullify the rights which have been thus created.

It is highly significant that the Securities and Exchange Commission in its report to Congress stated that neither of the two major companies (Fidelity Investment Association and Investors Syndicate) had registered their certificates under the Securities Act of 1933 "presumably by reason of the exemption in Section 3 (a) (8) of that Act." The footnote to said sentence points out that:

> "Sec. 3(a) (8) of the Securities Act of 1933 includes among the securities exempted from the registration and prospectus requirement of the Act, 'any insurance or endowment policy or annuity contract or optional

annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia.'"

Part Two, Statistical Survey of Investment Trusts and Investment Companies, p. 228.

Commissioner Healy, in his statement before the Sub-Committee of the Committee on Banking and Currency of the United States Senate, preceding the passage of the bill, compared these companies to savings banks (Part One hearings on S. 3580, pp. 33, 38).

Thus, until the enactment of the Investment Company Act of 1940, the Securities and Exchange Commission evidently held the view that investment companies selling face-amount certificates were exempted from the registration of their certificates under the Securities Act of 1933.*

Petitioners, for want of any better reason for the Central Trust Company's taking over the twenty millions of dollars worth of securities for distribution, say that it is better to wind up the company at Charleston in the Federal Court as that a lot of legal questions can be raised there. So far as we can discern from the petition this is the sole basis of their challenge of the finding of the Court of Appeals that the best interests of the contract holders would be subserved by the State proceedings. They naively assert:

"The prevalent theory of the States participating in this case is that the State deposits, except in West Vir-

*By the same token, it would seem that a face-amount certificate company would not be the type of corporation that could file a petition in bankruptcy, because it possessed the essential characteristics of an insurance or banking corporation. (Sec. 4 (b) of the Bankruptcy Act.)

ginia, are for the primary protection of the holders of the contracts sold in the respective States. This theory may, or may not, be sound. It should be judicially determined by a court having jurisdiction of all of the assets and of the persons interested before there is any distribution."

Then they go on to say that it is not for them to *answer* or *resolve* these questions *now* (one year after the taking of 4,000 pages of testimony covering the creation of the deposits with great detail), but that they are merely *making suggestions* demonstrating the necessity of witholding any distribution until they are settled.

What a windfall it would be to the Central Trust Company and its staff of attorneys (including those which have been loaned to the Debtor in their frenzied efforts to sustain this proceeding after the attorney who filed the petition evacuated the case) if this innocent-appearing little suggestion which "may or may not be sound" can be tested out at Charleston! Oh, what a scurrying there would be to find authorities to support elaborate pleadings raising the question of whether or not after all contract holders in Tennessee, Alabama, Kansas and the other States have any security, if only this Court would give them the green light. What a disaster it would be to eighty thousand contract holders who compare such subtleties of the law to the disputation of the ancient theologians about how many angels could stand on the point of a needle.

With liquidation in mind as the ultimate result of the litigation, petitioners say:

"Whether or not, if there should be liquidation, the assets should be distributed according to the States in which they are held and to the contract holders re-

siding therein, or according to the contract series funds for which Fidelity owned and held these assets, will be a real question which can be effectively determined only while the *res* is undistributed."

To prove that there can be no possible basis for the distribution of the deposits except the State laws under which they were created, it is necessary only to refer to the testimony of Mr. Raymond Latta. Before the receivership in the State Court, the company employed this expert actuary in an effort to devise some method of determining the "equities" of the contract holders with a view of effecting some rehabilitation. Mr. Latta remained in the employ of the Receivers and continued in the employ of the Trustee in Bankruptcy until September 15, 1941. (Record, p. 3223.) He was not called as a witness by the Debtor but was called as a witness by the defendants opposing reorganization. He had gone so far as to work out tentative or rough working plans. These were filed as Exhibits 111 and 112. (Record, p. 3255). One plan was called the Uniform Plan and the other the Graduated Plan. Under the Uniform Plan contract holders would receive 80 per cent or 85 per cent of their "equities." Under the Graduated Plan some of them would receive 90 per cent and the remainder would receive 30 per cent to 50 per cent. *Mr. Latta testified that no plan was ever devised which could be put into effect.* (Record, pp. 3305-3306). He attended conferences with the Securities and Exchange Commission. All of these plans looked to the company being transformed into a life insurance company. (Record, p. 3306).

Mr. Latta testified that it was impossible for them to determine the amount each fund had. This was because of the various loans and inter-fund transactions. After nine

months work on these problems, there were still questions which baffled this reorganization expert. For the convenience of the Court of Appeals, we are printing an excerpt from his testimony as Appendix C to this reply. This excerpt has been printed in the transcript of the record at pages 238-239.

The deposits in the several States in general secure the total liabilities in the States according to the laws of the State without distinction as to funds or series. No more power exists in this Court to readjust claims of contract holders between the different States so as to bring about a reshuffling of securities among the holders of the different series of contracts, than to take away the deposits themselves. This would be accomplishing by indirection what cannot be done directly.

The inescapable barrier to reorganization is the varying rights and interests of secured contract holders in the different States. It is unfortunate that there must be any loss. Still, since loss there must be, it should be borne where it falls. This Court cannot mitigate the misfortune of those having the lesser security by taking away any security from the better secured classes of contract holders. Moreover, the great complexity of interests would prevent the formulation of any fair modification of the existing rights of contract holders. Any such modification would have to be upon lines *wholly arbitrary*.

For the reasons given, no fair, equitable and feasible method of reorganization is possible in this case; and distribution of $20,000,000 of securities will have to be made according to State laws which required the deposits and govern the basis of distribution.

Why Proceedings in Bankruptcy Not to Best Interest of Contract Holders.

Whether we test the applicability of the Bankruptcy Act to Fidelity and the benefits expected to flow from it from the standpoint either of rehabilitation as a going concern, or liquidation, the same conclusion is inescapable.

Contract holders would suffer greatly from continued proceedings in bankruptcy because:

(a) Bankruptcy proceedings in this case would only serve to multiply and protract fruitless litigation and delay the payment of the just claims of contract holders; and

(b) A great amount of expense will be avoided if immediate liquidation of the State deposits in State Courts is permitted.

It has been shown that any litigation having the end in view of abrogating or modifying the State deposits as they existed at the time of the filing of the petition would be useless and detrimental to contract holders.

It is as plain as the noon-day that so far as Fidelity is concerned, no greater power over State deposits exists in the Bankruptcy Court since the enactment of the Investment Company Act, than there was before. We have seen that it was not the intention of Congress to disturb the State deposits as they existed on the effective date of the Act, which was January 1st, 1941. As Mr. Schenker stated to the Senate Sub-Committee on Banking and Currency, "meticulous care" was taken to see that those States which had deposits could hold on to them. (Printed Transcript, p. 229)

The Investment Company Act embodied a separate section headed "Bankruptcy of Face-Amount Certificate Companies." This Section 29 undertakes to amend Section 67 of the Bankruptcy Act so as to give the Bankruptcy Court summary jurisdiction over State deposits in proceedings for the *liquidation* of face-amount certificate companies.*

Section 29 expressly provides that it applies only to the deposit of securities made by a face-amount certificate company on or after January 1st, 1941. Deposits made prior to that time may not be avoided by the Trustee, and the Bankruptcy Court is given no summary jurisdiction of any proceedings to hear and determine the rights of any parties with respect to such deposits. It is to be borne in mind that all of the deposits of Fidelity were made prior to January 1, 1941.

That is not all. Sub-section (f) (5) of Section 29 provides:

> "Where the provisions of Sub-Section (c) of Section 28 are not applicable, the provisions of this Section shall not apply."

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*It is worthy of note that neither prior to the enactment of the Investment Company Act nor as a result of the amendment to that Acts was any *special* provision made for the *reorganization* of face-amount certificate companies. Whereas, the Bankruptcy Act contained separate chapters with carefully framed provisions concerning Agricultural Compositions and Extensions, Railroad Reorganizations, Debt Readjustments by Municipalities and Taxing Districts, Corporate Reorganizations, Arrangements, Real Property Arrangements and Wage Earners Plan, this simple amendment designed to facilitate the *liquidation* of face-amount certificate companies and the distribution of the deposits made after January 1st, 1941 was added by the Investment Company Act as an amendment to Section 67 of the Chapter relating to ordinary bankruptcy. It is in such striking contrast to the carefully detailed methods set up with respect to other types of corporations as to make it exceedingly doubtful whether in any event there would be jurisdiction in the Bankruptcy Court to attempt to *rehabilitate* a face-amount certificate company as a going concern. But this is not a determinative question.

Manifestly, it was intended that Section 29 relating to bankruptcy of face-amount certificate companies might have application to *some* companies but not to *all* companies.

Obviously, Section 28 referred to is the preceding Section of the Investment Company Act, the title of which is Face-Amount Certificate Companies. Sub-section (c) of Section 28 relates to regulations of the Securities and Exchange Commission applicable to deposits with trustees which may be required of *registered* face-amount certificate companies.

For two reasons, Section 28 (c) was not applicable to Fidelity, viz:

(a) According to the statement of the representatives of the Securities and Exchange Commission at the hearing, it was never a *registered* face-amount certificate company; and

(b) Sub-Section (g) of Section 28 rendered the entire Section 28 (including Sub-section (c) inapplicable to Fidelity because it provides that the Section shall not apply to a face-amount certificate company which on or before the effective date of the Act has discontinued the offering of face-amount certificates to the public. Fidelity did discontinue the offering of face-amount certificates to the public before the effective date of the Act.

We have shown that the assets of Fidelity outside of the State deposit are negligible; because as the record shows there is a claim of the Federal Government for unpaid income taxes in the amount of approximately $300,000.00, and after the payment of administration expenses, Court costs and attorneys' fees, very little, if anything, will re-

main from the non-deposited assets to be distributed to contract holders. To make the decision in this case turn upon the non-deposited assets or the possibility of some equity in one or more of the States to go back to the general fund would be putting the cart before the horse. Contract holders would be far better off to waive altogether their claims against the non-deposited assets than to let such a trivial amount control the disposition of Twenty Million Dollars of deposited securities held in State deposits.

Therefore, for all practical purposes, Fidelity's deposits, before the Investment Company Act was enacted, were not subject to the summary power of a court of bankruptcy. They did not become subject to such summary jurisdiction after the Act took effect. Indeed the failure of Congress to amend the reorganization sections of the Bankruptcy Act, when the Investment Company Act was passed is persuasive that it was not intended that those sections of the Bankruptcy Act so ill-adapted to the processes of reorganizing a face-amount certificate company would be resorted to. However that may be, when this company avoided the necessity of becoming a *registered* face-amount certificate company by discontinuing the offering of face-amount certificates to the public prior to January 1, 1941, it exempted itself from the only provision of the Bankruptcy Act which would have had direct application to the State deposits.

When consideration is given to the clear intent of Congress to leave the existing deposits undisturbed, it would not be consonant with justice to arrive at the result aimed at by the petitioners by resort to any forced or strained construction of the provisions of Chapter X of the Bankruptcy Act.

Surely there can be no gainsaying the following statement by the Court of Appeals:

> " . . . *certainly the possibility that thousands of contract holders could be persuaded to modify their contracts and scale down their claims to enable the company to go on is so remote as to exist only in the imagination. No proposal for the investment of new capital has been forthcoming.* The facts underlying the whole situation are so clear that even the parties in this case who insist upon reorganization under the Bankruptcy Act hold out little hope of a resumption of the business as a going concern, and content themselves for the most part with the argument that reorganization in the statutory sense includes 'a slow and orderly liquidation.' " (Italics ours).

Immediate Need of Liquidation for the Benefit of Contract Holders.

The Court of Appeals concluded that the immediate need was liquidation of the company's assets for the benefit of the contract holders. This was a *factual* determination. The evidence clearly sustains this conclusion.

It was developed at the hearing that the expenses of the receivership in the Federal Court at Charleston, before any allowance for administrative expenses, Federal Income Tax or the income from the deposited securities, Court costs, Trustees' fees and attorneys' fees was approximately $150,000.00 per annum. This is only a *part* of what it is costing contract holders to keep this proceeding in Court. (Tes. of J. H. Schellhase, pp. 2614-2620, typewritten record)

The statement in the opinion of the District Judge that the company's assets "might reasonably be expected to be largely dissipated in costs, fees, and market losses by forced liquidation" in a State Court proceedings, it seems to us, is wholly unwarranted. It is not amiss, we think, to make the observation at this point that from the standpoint of costs and expenses, the chief concern of contract holders is as to the following:

(a) The annual cost of $150,000.00 in administrative expenses of the trust estate while this litigation goes on;

(b) The compensation of the Central Trust Company and its attorneys and the multitudinous costs and expenses of this litigation in addition to the annual operating expenses of $150,000.00;

(c) The loss to contract holders from depreciation in securities already incurred since the litigation commenced, and the additional depreciation which will likely be suffered before the contract holders can get their money out of the insolvent concern;

(d) The large amount of additional income taxes that will accrue if the contention of the Federal Government is sustained that the estate must pay Federal income taxes on all of the income from the securities held in State deposits;

(e) Increased allowances to Receivers and attorneys representing contract holders and depositaries occasioned by reason of this proceeding;

(f) The untold amount of fees and expenses that will be incurred by contract holders for committees and attorneys in establishing and enforcing their rights if the estate has to be administered in Charleston, West

Virginia, and in a State far distant from the places where they reside and where the deposits securing their contracts are held;

(g) And what will be the most stupendous exaction of all the over-all fees on the whole $20,000,000.00 estate that may be allowed to the Central Trust Company in Charleston and the attorneys if the summary turn-over order directing that all State deposits be turned over to the Trustee is revived and a *slow* liquidation is conducted by the Trust Company at Charleston.

We do not feel that we can pass the discussion of this point, without observing that in this case there may be a *fast* and *orderly* liquidation in the several States. This is what the contract holders are entitled to. Fidelity is not the kind of corporation with which the Courts were dealing in the cases cited by the District Judge in his discussion of "slow" liquidation. We believe that it is a fair generalization that the assets of those corporations did not consist of liquid securities which were fairly readily marketable. The deposits of assets of Fidelity in the several States consist principally of bonds.

The Securities and Exchange Commission, in its Report on Investment Trusts and Investment Companies as to the type of investments made by the company, states: "The Association has followed a settled policy of investing its funds *almost entirely in marketable securities*, about ninety percent of which have consisted of bonds and notes." (Page 96 of Report) So far as we can recall, there is not an iota of proof that there will be any benefits to contract holders to whom these securities belong from having the

Central Trust Company (a moneyed corporation operating for profit) take over the deposits and reduce them to cash.

When petitioners speak of "slow liquidation", they really mean *slow distribution*. There would be some benefits from a slow distribution but those benefits would not inure to the contract holders. *They would be benefits to the Central Trust Company.*

CONCLUSION.

There is no important question of Federal law involved in this case. Certainly there is no question of Federal law involved in this case which this Court should undertake to settle. Even if this Court should disagree with the reasoning of the Court of Appeals, on the question of whether or not Fidelity was an insurance company within the meaning of the Bankruptcy Act when the petition was filed, it possesses no such omniscience as to enable it to declare principles which would be controlling in every such case that may hereafter arise. Any attempt to do so would result only in confusion worse confounded.

The decision of the Court of Appeals is a *just* one. There is no reason for this Court to permit this litigation to be prolonged. A decision that Fidelity was a kind of corporation that could file a petition under the Bankruptcy Act and sustaining the petition which has been filed would only result in years of wasting of the contract holders funds, while the Central Trust Company and its attorneys enjoy a very luscious plum.

Servant girls, miners, policemen and letter carriers have turned over their savings to this company to be invested

for them. The fact that deposit laws of the various States insured protection for these payments was no doubt the chief inducement that was used in selling the scheme. These people scattered in some twenty-nine different States cannot afford to employ lawyers and set up Committees to save their securities from being consumed in an utterly futile attempt to continue the operations of this defunct company through proceedings in a Federal Court in a distant State. They will not understand how the company could sell the contracts on the strength of guaranties from every quarter that they need never look beyond the boundaries of their own State for protection against loss because of the "safeguards" of the State deposit and then resort to the aid of a Federal Court in bankruptcy to take their security away from them.

We submit that the underlying issue is one of *good faith*. Debtor's case should be scrutinized with extreme care lest the Federal Courts unwittingly be used as an instrumentality for breaking faith with many thousands of humble persons who are as sheep dumb before their shearers.

Respectfully Submitted,

WELDON B. WHITE,
FYKE FARMER,
RUDOLPH K. SCHURR.

APPENDIX A.

CHAPTER 209 OF THE PUBLIC ACTS OF THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE, ENACTED MARCH 8, 1939, APPROVED MARCH 10, 1939.

SECTION 1. Be it enacted by the General Assembly of the State of Tennessee, That Section 6057 of the Code of Tennessee be amended by adding at the end thereof the following:

"Provided, however, that if the Securities offered or to be offered for sale to Tennessee be of the class known as 'Investment Contracts', comprising the following: investment contracts, or annuity contracts other than those of qualified insurance companies, or installment investment certificates, or securities of like kind, which contemplate that the issuer shall pay or deliver, or whereby the issuer agrees to pay or deliver, either absolutely or conditionally, to the purchaser or holder of the contract, certificate, bond, or like security, a sum of money at a future time, either with or without interest, in consideration of a payment or payments made or contemplated to be made by such purchaser or holder, which securities are hereinafter referred to as investment contracts; the investment company, or issuer, domestic or foreign, upon written request of the Commissioner of Insurance and Banking of this State, shall deposit and maintain with the said Commissioner, for the benefit of the holders of such investment contracts, a deposit of securities in cash or its equivalent; but the Commissioner of Insurance and Banking may, in his discretion, accept as said equivalent, such securities as domestic life insurance companies are permitted to invest their funds in under Section 6204 as amended of the official Code of Tennessee, in amount not less than $10,000 and at no time less than 100% of the issuer's cash or current contracts, liability on all such outstanding investment contracts, as defined herein, sold in the State of Tennessee. The Commissioner of Insurance and Banking of this State shall hold as custodian the securities deposited for the benefit of the holders of the investment contracts coming within the provisions of this Section.

"Securities deposited may be withdrawn at any time by the issuer at its option whenever other securities of like character are deposited in equivalent amount with the Commissioner of Insurance and Banking of this State in substitution therefor, or to the extent of any excess over 100% of the aggregate amount of the issuer's said cash or current contract liability on all such outstanding investment contracts sold in the State of Tennessee, provided only that the amount of said deposit shall not be reduced by such withdrawal below $10,000 unless the issuer has ceased to sell the investment contracts for which the deposit is maintained and no longer has authority to sell the same in this State. The Commissioner of Insurance and Banking of this State shall permit a reduction of such deposit by withdrawal of securities as herein provided upon the filing by the issuer of a proper affidavit showing that the amount of such deposit is in excess of the requirements of this Section. Upon discharge in full of all liabilities on all investment contracts sold in the State of Tennessee and for which such deposit is maintained, the issuer shall be entitled to a release and return of the securities so deposited. The issuer making such deposit shall be entitled to collect and receive the income and/or payments made on securities deposited; provided, however, that the amounts unpaid on deposited securities shall at no time be less than the minimum amount required to be deposited hereunder.

"The Commissioner of Insurance and Banking shall at least annually and oftener if he may deem it proper, appoint a disinterested qualified person or persons to make an examination and appraisement of the securities deposited with him, to determine if such securities meet the requirements of this Section, and the cost of such examination and appraisement shall be borne by the issuer of the investment contracts being sold or offered for sale in this State."

SECTION 2. BE IT FURTHER ENACTED, That this Act shall take effect from and after its passage, the public welfare requiring it.

APPENDIX A.

CHAPTER 157 OF THE PUBLIC ACTS OF THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE, ENACTED FEBRUARY 14, 1941, APPROVED FEBRUARY 15, 1941.

An Act to Make the State Treasurer the Custodian of all Collateral Held by or Deposited with the State or Any Department Thereof and to Fix His Duties and Responsibilities in Connection Therewith.

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE, That the State Treasurer be and he is hereby designated as the custodian of all collateral, securities, bonds and other valuable papers deposited with the State or any department thereof, and shall be exclusively responsible for the safekeeping thereof. It shall be the duty of each department head or other person in the State Government having in his or her possession collateral of the type above mentioned, to turn the same over to the State Treasurer upon the latter's request and to receive from the State Treasurer an itemized receipt therefor and as additional collateral, shall come into the hands of the department head or other person the same procedure shall be followed.

For the safekeeping of such collateral, the State Treasurer shall execute an additional bond in such sum as may be fixed by the Governor with the surety thereon to be approved by the Governor. He shall make an annual report to the Governor of the collateral in his hands, which report shall be made on or before December 15 of each calendar year. The expenses of such additional bond, if any, shall be paid from the appropriation made to the Treasurer's office.

SECTION 2. BE IT FURTHER ENACTED, That this Act shall take effect from and after its passage, the public welfare requiring it.

APPENDIX B.

(From Debtor's Petition for Reorganization.)

VII

Debtor further states that it now has outstanding investment and annuity contracts with reserve liabilities totaling approximately $25,000,000, and that in these contracts debtor agrees to pay interest accumulations of from four to five per cent per annum; that the decrease in interest rates in recent years has made it impossible for debtor to invest its funds in conformance with the West Virginia law and to earn the interest requirements as set forth in its said outstanding contracts; and that by reason of said interest requirements under its said contracts debtor is now suffering an annual loss of approximately $250,000 per annum, and that this loss will continue and probably increase unless the earnings on sound securities should increase far in excess of the present rate of income.

That for the reasons above set forth debtor has been unable to meet its obligations as they mature and will be unable to meet its obligations as they mature, *unless the rights of its contract holders are modified* so that the earnings received on securities and assets owned by debtor will be sufficient in amount to meet the requirements under its outstanding contracts; *and if the rights of its outstanding contract holders are modified to this extent*, debtor will be able to meet its reserve requirements and will be able to comply with the Investment Company Act of 1940 and will be enabled to resume the operation of its business.

Debtor further states that each of its existing and outstanding contracts is secured under the terms of each of its said contracts by a reserve fund, which is on deposit with the Treasurer of the State of West Virginia and *with the officials and departments of other states* where the securities of debtor were sold; and that the rights of *all* contract holders must be modified as above set forth in order that debtor may be permitted to obtain adequate relief, and that by reason of these facts debtor cannot obtain adequate relief under chapter 11 of the Bankruptcy Act.

VIII

Debtor further states that no plan of reorganization has been as yet formulated, and that it knows of no plan of reorganization, readjustment or liquidation affecting the property of the corporation pending either in connection with or without any judicial proceeding except that receiverships have been created in West Virginia and other states, some of which are threatening to sell the assets now in their possession.

APPENDIX C.

Excerpt from the Testimony of Raymond Latta, pp. 3252-3254:

"MR. PALMER:

Q. In any attempt, however, to rehabilitate the company before there were receivership proceedings, the fact that, let us say, the B fund had a 95% equity and the special annuity had, let us say, a 25% equity, was a difficult matter to work out. Wasn't that true? I mean, as a practical matter?

A. My experience there was they never determined what amounts each fund had. As far as working out a plan is concerned, it offered problems to what we were working toward, because we had no assumptions to make toward determining the equity of each fund.

Q. Let me develop that a little more fully. You attempted to find out how much equity or cash against liability each policy holder of each series of contracts would have. Is that correct—roughly?

A. Worked out statements of that nature revealing information of that nature, with innumerable assumptions made.

Q. What was that?

A. We tried to develop figures along that nature, with—making innumerable assumptions—a number of them, I mean.

Q. Part of the trouble was that you had loans between funds and transactions between funds as shown by the books of the company. Isn't that true?

A. Yes, sir.

Q. And you would have to assume in some instances that the loan would be paid back by one fund to the other fund before you would work on it. Isn't that right?

A. We made various assumptions.

Q. Yes! That was one of the assumptions you made.

A. Yes.

Q. And in other assumptions, you just took the reserve as shown by the books of the company as belonging to that fund, without paying back any of its loans in other funds and worked on that assumption.

A. We made various assumptions along that line; yes.

Q. You had no way, prior to receivership proceedings being brought, of determining which of your assumptions would be lawfully and legally correct?

A. Did you put a date in there? I can't answer that with a date.

Q. You had no way of determining that any of your assumptions was lawfully and legally correct?

A. I haven't heard the answer as yet, if that is what you mean.

Q. By that you mean the answer to the question is that you had no way of determining it?

A. That's right."